



LOCAL NETWORK SERVICES . . . *Lead with Local*

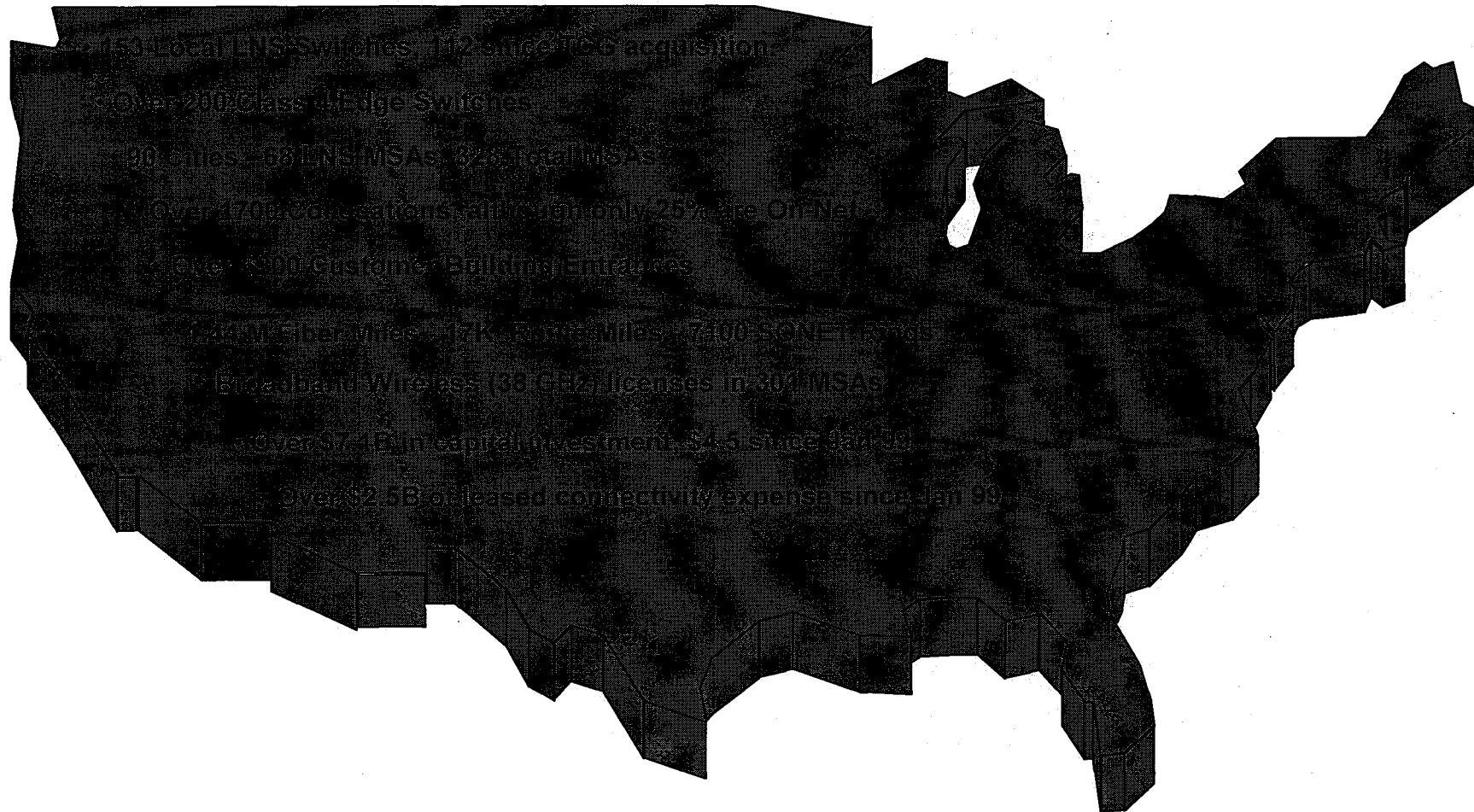
Transport UNEs Are a Prerequisite for the Development of Facilities- Based Local Competition

AT&T Presentation
October 7, 2002



LOCAL NETWORK SERVICES . . . *Lead with Local*

AT&T has invested billions in local network facilities





CLECs Must Lease Interoffice Transport As Part of Their “Loops” to Originate and Terminate Traffic

- CLECs lease interoffice transport in two parts of their local networks
 - CLEC node to CLEC node (“trunk side” of the collocation)
 - ILEC node to CLEC node (“line side” of the collocation)
- Line side interoffice transport is purchased as part of an extended loop, or EEL. This provides the CLEC with the equivalent of ILEC local loop connectivity
- EELs are a part of the CLEC hub design that enables customer growth and incents network build-out as utilization improves
- The hub design becomes less efficient and less economical when CLECs have to pay above-cost prices to ILECs for connectivity to the customer





Construction of Duplicative Transport Is Generally Uneconomic

- ❧ ILEC transport networks are ubiquitous and fiber-based and characterized by enormous economies of scale and scope, a function of their historic monopolies
- ❧ Facilities costs are predominantly in the infrastructure (ROW, conduit, poles, etc.)
- ❧ Conductor costs are minimal in comparison
- ❧ ILEC networks thus have substantial excess capacity and can be expanded without need for new construction
- ❧ CLEC cost disadvantages in constructing transport can be greater than 200%
- ❧ These disadvantages leave limited opportunities for CLECs to aggregate sufficient demand to construct transport networks
- ❧ The current capital crunch makes CLEC construction even more difficult



Practical and Operational Limitations on Facilities Construction

- ❧ Obtaining necessary franchise/rights of way from local government
 - Extended negotiation and ratification processes
 - Imposition of unreasonable conditions and/or fees
 - Similar conditions not imposed on original ILEC construction
- ❧ Requirement of third-party agreements for existing rights of way and building access
- ❧ Limitation on use of existing ILEC ROW/Building Access
 - Conditions prohibiting ability to extend ROW to 3d Party
 - ILEC delays and conditions
- ❧ Construction delays due to labor, equipment or other supply constraints
 - Moratoria on new construction or construction coordination delays
 - Uncertainty concerning joint build partners



There Is No Competitive Wholesale Transport Market

- ❧ CLECs generally have no option to ILEC transport
 - AT&T generally has no option but the ILEC
 - Allegiance leases 70% of interoffice DS3s from ILECs
 - “Collocation hotels” typically do not serve CLECs and are otherwise do not meet CLEC needs
- ❧ Limited alternatives to special access are not cost-based but are priced under the ILEC price umbrella
- ❧ CLECs that offer “alternatives” frequently use ILEC facilities, and many are in bankruptcy
- ❧ The very high price of the special access “option” gives the ILECs significant cost advantages

CLECs must be able to lease transport from the incumbent LECs in order to compete



AT&T's Efforts to Expand the Reach of Its Local Network Have Been Seriously Compromised by Its Inability to Lease ILEC-Owned Facilities at Cost-Based Rates

- The ability to lease facilities at cost-based rates enables carriers to offer competitively priced DSx services. Customer acquisition in turn leads to network expansion as asset utilization increases
- AT&T has been unable to obtain leased facilities at rates that reflect their true economic cost
 - Contrary to AT&T's expectation, leased DS0, DS1 and DS3 facilities can be obtained only from special access tariffs, at greatly inflated rates compared to ILEC costs
 - As a consequence, AT&T is now beginning to shrink its network footprint, eliminating collocation cages



Artificially High Transport Costs Have Led to the Under-Utilization of Network Assets. AT&T Is Responding by Decommissioning Collocation Cages

- AT&T has invested substantial capital to construct and equip collocation cages around the country, expecting that it would be able to generate sufficient demand volumes to make the investment economic
- However, many of AT&T's collocation cages are significantly under-utilized due to the impediments it has faced to in its efforts to efficiently and economically aggregate traffic
- AT&T is therefore in the process of decommissioning over 100 collocation cages where it has been determined that we cannot economically meet customer price and performance expectations
- *Cost-based transport rates would help reverse this backwards trend*

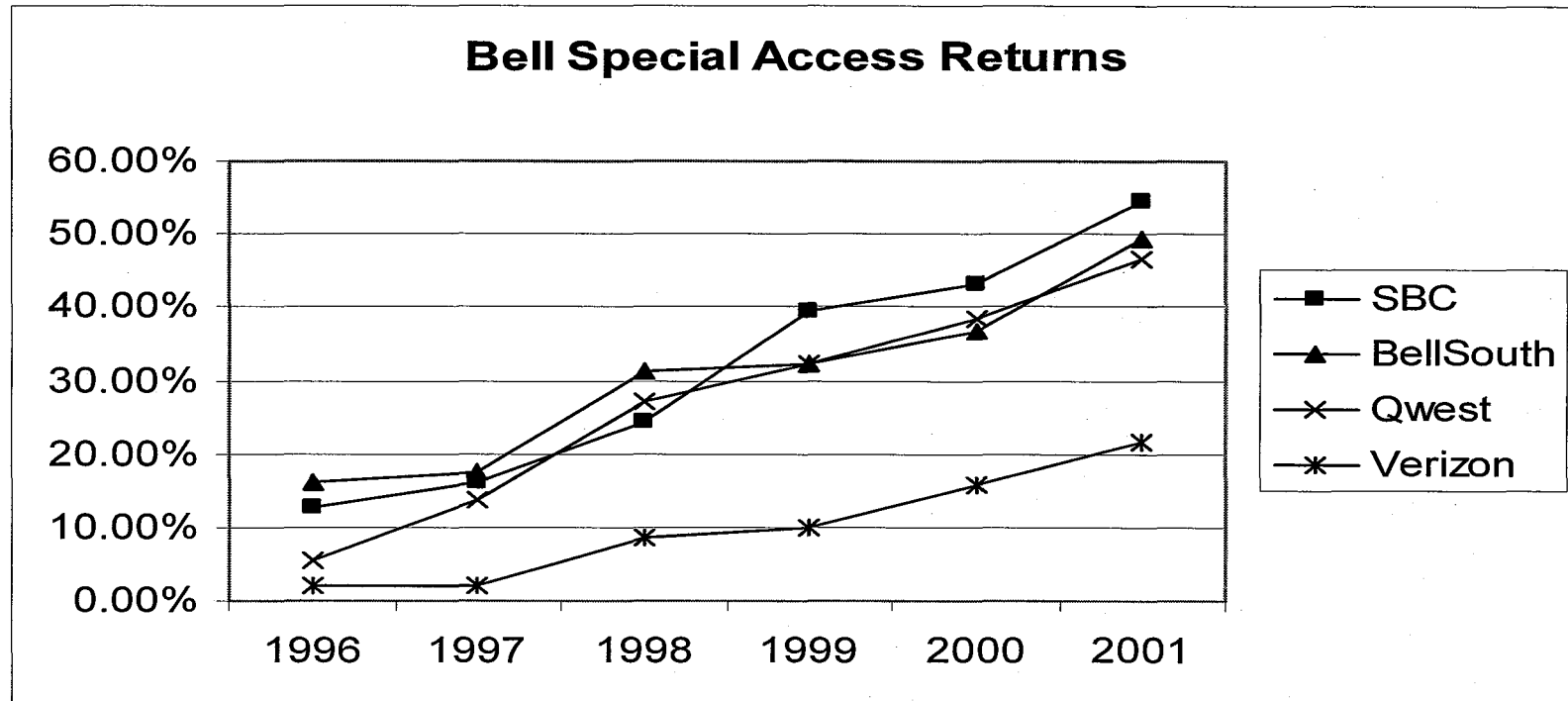


Requiring CLECs to Use Special Access to Lease Transport Facilities Is a Substantial Disincentive to Build

- Approximately 40,000 of AT&T's local customers require DS1-level service
 - 65% of these local DS1 customers require loop/transport combinations (EELs) to carry traffic to and from AT&T's collocation cages
 - ILECs don't require EELs due to their vast networks
- 98% of AT&T's DS1 customer loops/EELs are leased from ILECs under their Special Access tariffs; only 2 percent are leased as UNEs
 - At special access rates, AT&T's cost for EELs is more than 45% higher than the ILECs' TELRIC cost of providing the service. This leads to retail/wholesale price squeezes and inflated ILEC earnings



ILECs Earn Supra-Competitive Rates of Return on Special Access Priced Facilities. These “Interstate” Returns Have Increased Dramatically Since the Advent of “Local” Competition





Premature Deregulation of Special Access Has Exacerbated this Situation, Giving the ILECs the Opportunity to Further Increase Monopoly Profits and Price Squeeze Their Competitors

- ▲ ILECs have responded to pricing flexibility by *raising* special access rates
- ▲ Optional Payment Plan (OPPs) are becoming *more restrictive* and offer *smaller effective discounts*, because price increases are not offset by OPP discounts. One RBOC OPP even restricts our ability to buy UNE priced facilities
- ▲ With these wholesale price increases, ILECs have improved their opportunity to impose price squeezes, which will further stunt if not eliminate competition
- ➡ Excessive special access rates mask the ILECs' true unit costs and send inaccurate signals as to the routes over which build-out might be economically efficient. This leads to stranded assets

Overall, ILECs have benefited immensely from special access deregulation, leaving CLECs/IXCs to face increased costs, decreased flexibility and even less opportunity to compete

CLECs therefore need fresh look relief from OPP penalties and restrictions



The “Interim” Use/Commingling Restrictions Impose Additional Impediments on Network Build-Out and Should Be Eliminated

- The Commission’s basis for allowing “interim” restrictions was a concern regarding universal service subsidies. There are no more USF subsidies in special access
- Impairments related to interoffice transport are identical regardless of the service being provided over those facilities
- Use/commingling restrictions prevent CLECs from gaining access to loop/transport combinations at UNE rates to provide local service. ILECs are not subject to the same restriction when they provide retail service; e.g. Mass.
- These restrictions deny the CLEC from sharing in the ILECs’ substantial economies of scale and scope. ILECs are not subject to the same restrictions when they enter the LD market
- Interim use/commingling restrictions are discriminatory because they require CLECs to maintain separate networks for interLATA-bound traffic
- Interim use/commingling restrictions prevent CLECs from aggregating traffic to levels required to justify investment in owned facilities



In Addition to Transport Costs, CLECs Face Substantial Additional Leased Connectivity Costs When Building a Local Network

- Collocation Costs - The cost of a collocation cage ranges from \$2,500 per month to over \$20,000 per month. Rates vary from state to state and company to company. Facilities-based competition is rarely economical when a CLEC must recover the cost of 1, 2 and sometimes 3 high-priced cages to originate and terminate traffic
- Interconnection Costs - CLEC costs to terminate traffic to ILECs are increasing as a result of transit traffic and LEC proposals that would substantially increase trunking costs, *e.g.* GRPS
- Other Leased Infrastructure Costs - In addition to the above costs, CLECs also pay substantial expense to ILECs for multiplexing. Multiplexing prices are also not at TELRIC, and together with leased collocation and leased interconnection, these infrastructure costs can significantly increase CLECs' overall cost of providing facilities-based service



In Sum, CLECs Require Leased Transport Facilities at Cost-Based Rates and Free of Restrictions to Support an Economically Efficient Local Network Build-Out

- ➡ Until true cost-based rates are secured, CLEC unit costs for serving customers and managing networks will remain substantially -- and artificially -- above the ILECs' costs. Competitive carriers should be able to lease interoffice transport at UNE rates
- ➡ ILECs should not be allowed to invent operational barriers whenever they lose a regulatory or pricing decision, e.g. ASR vs. LSR ordering processes; VZ's "no facilities" claims
- ➡ Adequate performance measures and remedies must be available
- ➡ Interim use/commingling restrictions must be removed, with a "fresh look" provision for existing contracts to give Transport UNEs a chance to work



If the Commission Considers Any De-listing of Transport UNEs, the Following Factors Must Be Included in the Review

- The proposed ILEC “triggers” do not demonstrate that there are actual alternatives and assume that CLECs should build on speculation; they must be rejected
- The relevant market for transport facilities is extremely localized. Thus, de-listing should only be considered:
 - On a route-specific basis between specific pairs of ILEC wire centers, and only where CLECs can gain practical and economic access to alternative supply
 - By State Commissions who tend to have more localized knowledge of these routes.
- ❏ When examining alternative supply, de-listing should be considered only where there are sufficient carriers (4-5) *offering their own supply*, to assure competitive and efficient pricing after the ILEC is freed of its unbundling obligations
 - Alternative carriers must be financially stable and have sufficient capacity to meet the projected needs for all CLECs on specific routes
 - CLECs must not be required to build “patchwork” networks
 - Cross-connects must be practically available without risk of service disruption
 - Multi-vendor testing must be available
- ❏ A transition period should be established, with Transport UNEs being generally available during the transition, during which carriers would be allowed to seek alternative arrangements along de-listed routes. No tools yet exist to manage such a process